

The Federal Budget: Overview and Issues for FY2015 and Beyond

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Summary

The federal budget is central to Congress's ability to exercise its "power of the purse." Each fiscal year Congress and the President undertake a variety of steps intended to set levels of spending and revenue and to make policy decisions. The purpose of this report is to provide an overview and background on the current budget debate. This report will track legislative events related to the federal budget and will be updated as budgetary legislation moves through Congress.

In recent years, policies enacted to restrain spending, along with a stronger economy, have led to reductions in the budget deficit. On August 2, 2011, the President signed into law the Budget Control Act of 2011 (P.L. 112-25). The BCA contained a variety of measures intended to reduce the deficit by at least \$2.1 trillion over the FY2012-FY2021 period, along with a mechanism to increase the debt limit. Two subsequent pieces of legislation have modified the BCA since it was enacted—the American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240) and the Bipartisan Budget Act of 2013 (BBA; P.L. 113-67). Both pieces of legislation allow for more discretionary spending than was provided under the BCA for FY2013, FY2014, and FY2015. Various deficit reduction measures were included to offset the costs of the changes to spending levels in both ATRA and the BBA. The BCA and the BBA will continue to affect spending levels in FY2015 and beyond as Congress may debate whether or not to enact further changes.

The Obama Administration released its FY2015 budget in two parts—the first on March 4, 2014, and the second on March 10, 2014. In his budget, President Obama proposes an "Opportunity, Growth, and Security Initiative" to provide additional funding for unspecified discretionary programs in FY2015. The budget also proposes to eliminate the BCA sequester on mandatory programs in FY2015. These proposals yield a deficit for FY2015 that is slightly higher than what is currently projected in the CBO baseline.

Congressional consideration of FY2015 budget and appropriations legislation has already begun. The BBA contained a provision directing the House and Senate Budget Committee chairmen to file spending and revenue levels in the *Congressional Record* that would be enforceable in the same manner as a concurrent budget resolution for FY2015 if an agreement on a budget resolution could not be reached by April 15, 2014. However, nothing would preclude Congress from acting on a budget resolution for FY2015 even after those levels have been filed. It has been reported that Senate Budget Committee Chairman Patty Murray has signaled that the provisions contained in the BBA make a budget resolution for FY2015 unnecessary. On April 10, 2014, the House agreed to a budget resolution (H.Con.Res. 96, 113th Congress) by a vote of 219 to 205.

Though the federal budget deficit has fallen in recent years, CBO, GAO, and the Administration agree that current federal fiscal policies are unsustainable in the long term. Projections indicate that putting the federal budget on a sustainable long-term path will require an agreement on additional deficit reduction. Such an agreement could include increases in revenues, changes to large spending programs, or some combination of the two.

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The federal budget is central to Congress's ability to exercise its "power of the purse." Federal budget decisions also express Congress's priorities and reinforce Congress's influence on federal policies. Making budgetary decisions for the federal government is a complex process and requires balancing competing goals.¹ Recent economic turmoil put a strain on the federal budget due to declining revenues and increasing spending levels. Subsequently, policies enacted to restrain spending, along with a recovering economy, have improved the budget outlook, at least in the near term.

In August 2011, budget negotiations resulted in the enactment of the Budget Control Act of 2011 (BCA; P.L. 112-25), which contained provisions to reduce the budget deficit by about \$2 trillion over the next decade. Since that time, various legislative changes to the law have lessened the impact on certain types of federal spending.² In addition, the long-term costs of federal health care programs and the effects of the baby boom generation's retirement continue to put pressure on the federal budget and have yet to be addressed. Operating these programs in their current form may pass on substantial economic burdens to future generations. Congress and the President may consider proposals for additional deficit reduction as fiscal issues may remain a key component of the legislative agenda.

This report will provide an overview of federal budget issues, focusing on recent fiscal policy changes. It will also discuss the major policy proposals contained in the President's FY2015 budget and the House and Senate budget resolutions. Finally, it also addresses major short- and long-term fiscal challenges. This report will track legislative events related to the federal budget and will be updated as budgetary legislation moves through Congress.

Overview

Each fiscal year Congress and the President undertake a variety of steps intended to set levels of spending and revenue and to make policy decisions. This section provides a brief summary of the budget cycle along with an explanation of how budget baselines are constructed. Budget baselines are used to measure how legislative changes affect the budget outlook and are integral to making these policy choices.

Budget Cycle³

A single year's budget cycle takes roughly three calendar years from initial formation by the Office of Management and Budget (OMB) until final audit.⁴ The executive agencies begin the budget process by compiling detailed budget requests in the calendar year before the President's budget submission. Many agencies start working on their budgets during the spring and summer—about a year and a half before the fiscal year begins. OMB oversees the development of these agency requests. The President submits a budget to Congress, which is based on work by

¹ For more information, see CRS Report 98-721, *Introduction to the Federal Budget Process*, coordinated by Bill Heniff Jr.

² For more information on the BCA, see CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan and CRS Report R43411, *The Budget Control Act of 2011: Legislative Changes to the Law and Their Budgetary Effects*, by Mindy R. Levit.

³ This section provides an outline for the formulation and execution of a budget and appropriations cycle for a fiscal year. However, this timetable is not set in law and is often not adhered to. For more information on the effects of not adhering to "regular order," see the section titled "Recent Budget Policy Legislation and Events."

⁴ CRS Report 98-325, *The Federal Fiscal Year*, by Bill Heniff Jr.

OMB and federal agencies, typically around the first Monday in February or about eight months before the fiscal year begins.⁵

Congress typically begins formal consideration of the budget resolution once the President submits his budget request. The budget resolution sets out a plan, agreed to by the House and Senate, that establishes the framework for subsequent budgetary legislation. Because the budget resolution is a concurrent resolution, it is not sent to the President for approval.⁶

Congress does not always complete action on a budget resolution. In years when Congress is late in adopting, or does not adopt, a budget resolution, the House and Senate independently may adopt “deeming resolution” provisions for the purpose of enforcing certain budget levels. The last time the House and Senate agreed to a budget resolution was for FY2010. The FY2010 budget resolution was agreed to on April 29, 2009.⁷

House and Senate Appropriations Committees and their subcommittees typically begin reporting discretionary spending bills after the budget resolution is agreed upon. Appropriations Committees review agency funding requests and propose levels of budget authority (BA). Appropriations acts passed by Congress set the amount of BA available for specific programs and activities. Authorizing committees, which control mandatory spending, and committees with jurisdiction over revenues also play important roles in budget decision making.⁸

During the fiscal year, which begins on October 1, Congress and OMB oversee the execution of the budget. Once the fiscal year ends on the following September 30, the Treasury Department and the Government Accountability Office (GAO) begin year-end audits.

Budget Baseline Projections

Budget baseline projections are used to measure how future legislation would affect the budget picture. They are not meant to be predictions of the future budget outlook. Due to the nature of projections, slight changes in assumptions can lead to large effects in outyear totals. Therefore, it is important to understand what projections include and the assumptions on which they are based. Baseline projections are included in both the President’s budget and the congressional budget resolution.

The Congressional Budget Office (CBO) computes current law baseline projections using assumptions set out in budget enforcement legislation.⁹ Since Congress and the President have resolved certain questions related to expiring tax policy and have enacted specific policies set to control discretionary spending over the next decade, there are fewer policy uncertainties affecting the baseline levels under current law. More specifically, the American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240; see additional discussion below) permanently set into law many individual tax rates and tax policy provisions. On the spending side, baseline discretionary spending levels are largely constrained by the caps and automatic spending reductions enacted as

⁵ The contents of the Presidential budget submission are governed by 31 U.S.C. §1105. For reasons why the budget may be delayed, see CRS Report RS20179, *The Role of the President in Budget Development*, by Clinton T. Brass.

⁶ For more information, see CRS Report RL30297, *Congressional Budget Resolutions: Historical Information*, by Bill Heniff Jr. and Justin Murray.

⁷ S.Con.Res. 13, 111th Congress.

⁸ For more information on the appropriations and authorization process, see CRS Report R42388, *The Congressional Appropriations Process: An Introduction*, by Jessica Tollestrup.

⁹ Many of the rules governing the baseline contained in §257 of the Balanced Budget and Emergency Deficit Control Act, as amended, were extended or modified as part of the Budget Control Act of 2011 (P.L. 112-25).

part of the Budget Control Act of 2011 (BCA; P.L. 112-25) and further modified by the Bipartisan Budget Act (BBA; P.L. 113-67; see additional discussion below).¹⁰ In addition to these current law assumptions, macroeconomic assumptions, specifically of gross domestic product (GDP) growth, inflation, and interest rates, will also affect the baseline estimates and projections.

However, the CBO baseline also incorporates certain assumptions currently in law, but that have historically been revised prior to the policy change actually taking effect. Specifically, the CBO baseline assumes that sharp reductions in Medicare's payment rates for physician services will take effect as scheduled in April 2015 and that certain expired and expiring tax provisions will not be extended.¹¹ The projections in the baseline also contain additional uncertainty, particularly as it relates to future federal borrowing and healthcare costs. Minor changes in the economic or technical assumptions that are used to project the baseline also could result in significant changes in the outyear deficit levels.¹²

Current baseline projections show continued reductions in the budget deficit over the next several years, from 4.1% of GDP in FY2013 to 2.6% of GDP in FY2015, and roughly similar deficits as a percentage of GDP through FY2018.¹³ These declining deficit figures, relative to the past few fiscal years, are primarily due to continued improvements in the economy, restraints on discretionary spending, and certain assumptions used in constructing the baseline (i.e., certain tax provisions will expire as scheduled under current law). This would result in budget deficits that slightly reduce the level of debt held by the public as a percentage of GDP through FY2018. In other words, these budget deficits would be fiscally sustainable.¹⁴ However, after FY2018, deficit levels are projected to rise again, reaching 4.2% of GDP by FY2022 and 4.0% of GDP by FY2024. Under the baseline assumptions, budget deficits are projected to average 3.5% of GDP over the FY2015 to FY2024 period. (See **Table 1** below.)

Table 1. Selected CBO Baseline Budget Projections
(percentage of GDP)

	FY2013 (actual)	FY2018	FY2024
Budget Deficit	4.1%	3.1%	4.0%
Debt Held by the Public	72.1%	72.6%	79.2%

Source: CBO, *The Budget and Economic Outlook: 2014 to 2024*, February 2014, Table 1-2.

CBO also provides projections based on alternative policy assumptions, which illustrate the levels of spending and revenue if current policies continue, rather than expire as scheduled under current law. If Medicare payment rates for physician services remain the same, expiring tax

¹⁰ The BCA allows for discretionary spending to be adjusted for war funding, disaster, emergency, and program integrity spending.

¹¹ Most of these tax provisions expired in December 2013 but have been retroactively extended in the past. Others expire at the end of 2017. For more information, see CRS Report R43124, *Expired and Expiring Temporary Tax Provisions ("Tax Extenders")*, by Molly F. Sherlock. Congress has traditionally enacted a series of laws to override the reductions in physician Medicare payments by adjusting the sustainable growth rate (SGR) formula. For more information, see CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn.

¹² CBO, *The Budget and Economic Outlook: 2014 to 2024*, February 2014, pp. 19, 22.

¹³ Unless otherwise noted, budget data in this report are taken from the tables in CBO, *The Budget and Economic Outlook: 2014 to 2024*, February 2014.

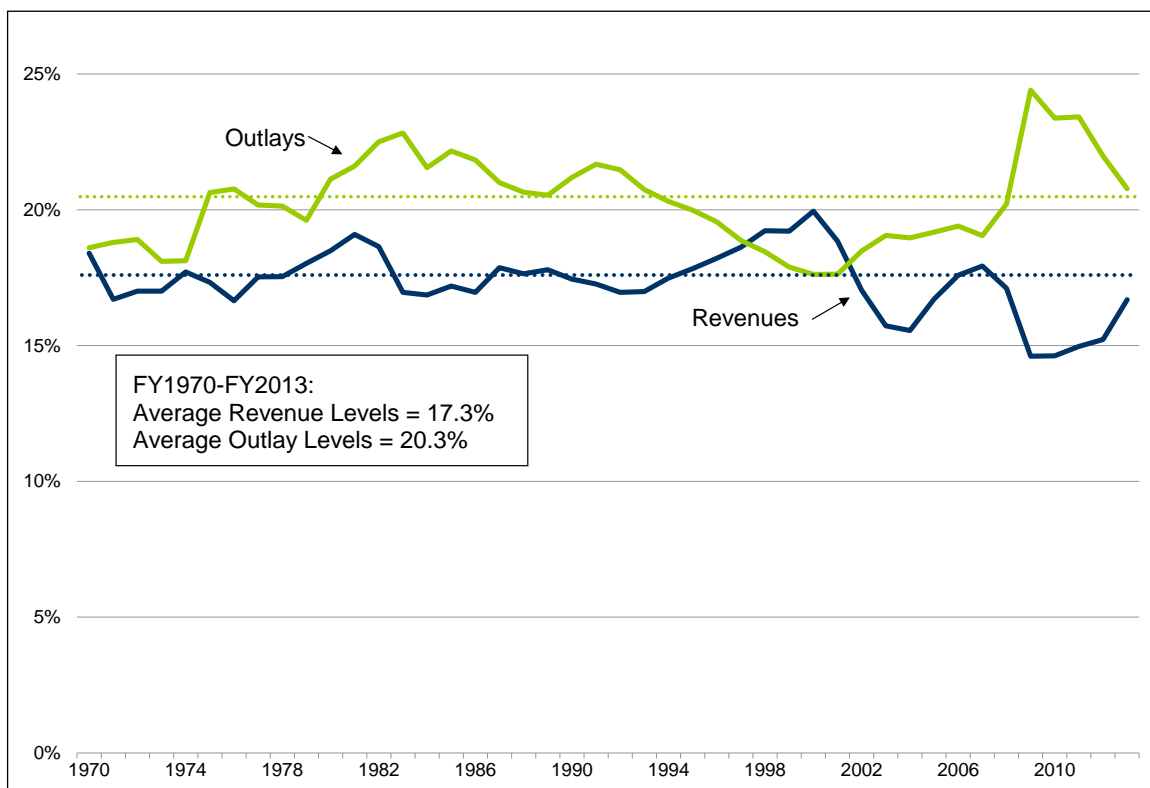
¹⁴ Budget deficits are considered sustainable if the budget deficit as a percentage of GDP does not exceed the growth in the economy. Generally, this implies a budget deficit of less than 3% of GDP.

provisions are extended, and the provisions of the Budget Control Act's automatic spending reduction process do not remain in effect for FY2015 and beyond, CBO projects a cumulative increase in the budget deficit by more than \$2.3 trillion relative to the current law baseline, including increased debt service costs, over the FY2015 to FY2024 period. Beyond the 10-year forecast window, federal deficits are expected to grow unless major policy changes are made. This is a result of increased outlays largely attributable to health care costs and baby boomer retirements.

Spending and Revenue Trends

Over the last four decades, on average, federal spending accounted for approximately 20% of the economy (as measured by gross domestic product), while federal revenues averaged roughly 17% of GDP. Since FY2002, spending exceeded revenue in each fiscal year resulting in budget deficits. Over the last several fiscal years, spending and revenue have deviated significantly from historical averages primarily as a result of the economic downturn and policies enacted in response to financial turmoil. As the economy recovers, the budget deficit continues to fall. In FY2013, the U.S. government spent \$3.5 trillion and collected \$2.8 trillion in revenue resulting in a budget deficit of 4.1% of GDP, the lowest imbalance in five years. The trends in revenues and outlays between FY1970 and FY2013 are shown in **Figure 1**.

Figure 1. Total Outlays and Revenues, FY1970-FY2013
(as a percentage of GDP)



Source: CRS figure using data from CBO, *Historical Tables*, February 2014.

Federal Spending

Federal outlays are often divided into the broad categories of discretionary and mandatory spending, and net interest.¹⁵ Discretionary spending is controlled by annual congressional appropriations acts. Mandatory spending encompasses spending on entitlement programs and spending controlled by laws other than annual appropriation acts.¹⁶ Entitlement programs such as Social Security, Medicare, and Medicaid make up the bulk of mandatory spending. Congress sets eligibility requirements and benefits for entitlement programs, rather than appropriating a fixed sum each year. Therefore, if the eligibility requirements are met for a specific mandatory program, outlays are made automatically. Net interest comprises the government's interest payments on the debt held by the public, offset by small amounts of interest income the government receives from certain loans and investments.¹⁷

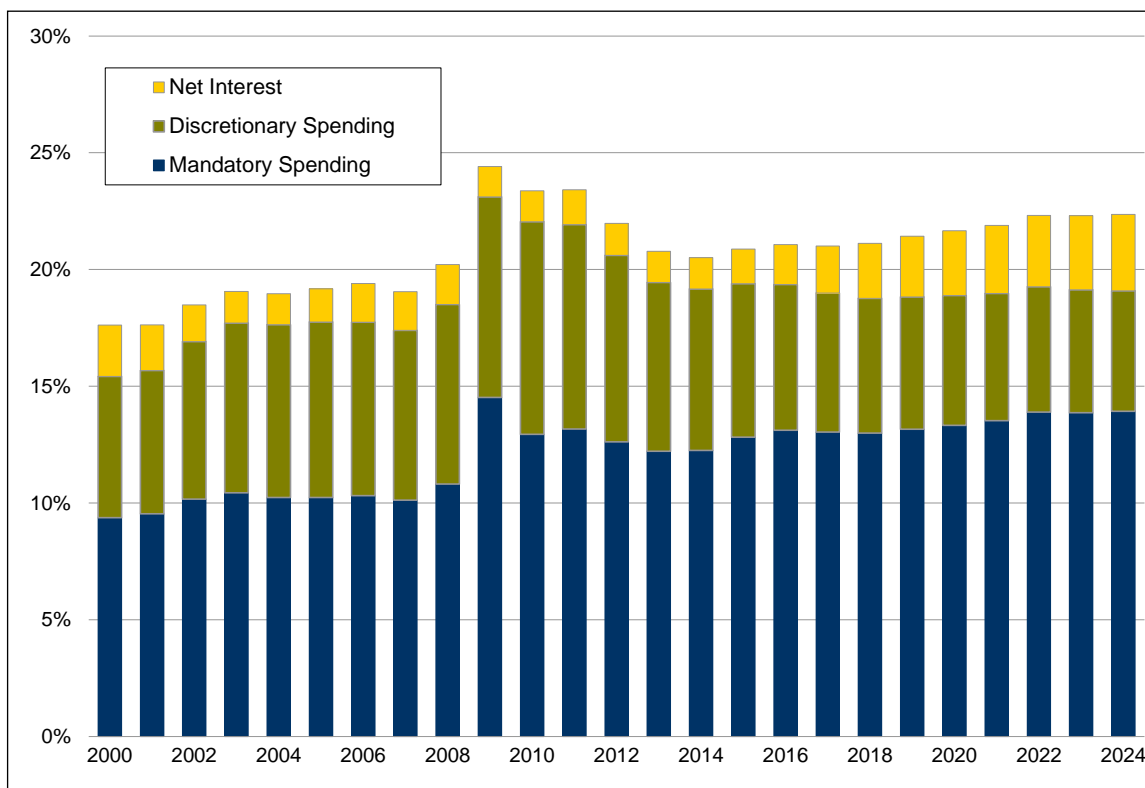
In FY2000, total outlays equaled 18.2% of GDP. In FY2009, outlays peaked at 24.4% of GDP. Outlays have fallen since then, but remain at levels above the historical average. In FY2013, total outlays were 20.8% of GDP. Under the CBO baseline, total outlays are projected to be 22.4% of GDP in FY2024. **Figure 2** shows the level of federal spending as a percentage of GDP, broken into the discretionary, mandatory, and net interest categories, between FY2000 through FY2024, as projected in the CBO baseline.

¹⁵ The division between discretionary and mandatory spending was first put into place in FY1962.

¹⁶ For more information on trends in discretionary and mandatory spending, see CRS Report RL34424, *Trends in Discretionary Spending*, by D. Andrew Austin and CRS Report RL33074, *Mandatory Spending Since 1962*, by Mindy R. Levit and D. Andrew Austin.

¹⁷ Net interest is discussed in further detail below in the section "Deficits, Debt, and Interest."

Figure 2. Outlays by Type, FY2000-FY2024
(as a percentage of GDP)



Source: CRS figure using data from CBO, *Historical Tables*, February 2014 and *The Budget and Economic Outlook: 2014 to 2024*, February 2014, Table I-2.

Notes: Data for FY2014 are estimates and data for FY2015-FY2024 are projections under the current law baseline.

Discretionary spending peaked in FY2010 at 9.1% of GDP. In FY2013, discretionary spending totaled 7.2% of GDP. Since FY2000, discretionary spending as a share of GDP has increased 5.3% a year, on average. Increases in discretionary spending over this period have largely been a result of increases in security spending¹⁸ and, more recently, the funding provided in the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5). On average, from FY2000 to FY2013, defense discretionary outlays grew 5.9% per year in nominal terms, while non-defense discretionary outlays grew 4.6% per year in nominal terms. However, by FY2018, according to CBO's baseline projections, discretionary spending will fall to 5.8% of GDP, its lowest level ever. Discretionary spending in FY2024 is projected to total 5.2% of GDP. The projected decline in discretionary spending in the baseline over the next decade is largely due to the reductions under current law contained in the Budget Control Act.

Mandatory spending totaled 12.2% of GDP in FY2013, up from 9.7% of GDP in FY2000, as shown in **Figure 2**. Mandatory spending peaked in FY2009 at 14.5% of GDP. Mandatory spending levels have been elevated mainly as a result of increases in outlays for income security programs. Though the economic recovery is expected to lower mandatory spending on certain

¹⁸ The definition of security spending has varied over time. The Obama Administration has defined security spending as funding for the Department of Defense – Military, the Department of Energy's National Nuclear Security Administration, International Affairs (budget function 150), the Department of Homeland Security, and the Department of Veterans Affairs. Security spending has defense and non-defense components.

programs over the next few fiscal years, the growth in mandatory spending is projected to resume its upward trend towards the end of the decade due to increases in certain entitlement programs. As a result, under current law, CBO projects that mandatory spending will total 13.9% of GDP in FY2024, higher than the FY2013 level.

In addition to their size relative to the economy, the components of federal spending can also be examined relative to each other. In FY2013, mandatory spending totaled 58.8% of total outlays, discretionary spending totaled 34.8% of total outlays, and net interest comprised the remaining 6.4% of total outlays. The largest mandatory programs, Social Security, Medicare, and the federal share of Medicaid, constituted 48.0% of all federal spending in FY2013. By FY2024, mandatory and net interest spending are projected to increase, thereby reducing discretionary spending's share of total outlays. Mandatory spending is projected to rise to 62.3% of total outlays while discretionary spending's share is projected to fall to 23.1% in that year. Net interest spending is projected to rise to 14.7% of total outlays in FY2024.

Because discretionary spending represents roughly one-third of total federal outlays, some budget experts contend that to achieve significant reductions in federal spending, reductions in mandatory spending are needed. Other budget and social policy experts contend that cuts in mandatory spending would cause substantial disruption to many households, because mandatory spending comprises important parts of the social safety net.¹⁹ Even though the budget deficit has recently been declining, future projections of increasing deficits and resulting high debt levels still warrant further action to restore fiscal health over the long term.²⁰

Federal Revenue

Revenue collection has remained depressed over the last few fiscal years as the result of the economic downturn and certain tax relief provisions. In FY2009 and FY2010, revenue collection totaled 14.6% of GDP. In FY2013, federal revenue collection totaled 16.7% of GDP, which remains below the historical average.

Policies enacted during the 112th Congress enhanced certainty with respect to the revenue outlook. The American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240) permanently extended existing tax rates for most income groups, while raising tax rates for upper-income households beginning in calendar year 2013.²¹ Under the CBO baseline, revenues are projected to total 18.4% of GDP in FY2024.

Individual income taxes have long been the largest source of federal revenues, followed by social insurance (payroll) and corporate income taxes.²² In FY2013, individual income tax revenues totaled 7.9% of GDP. Social insurance tax revenue accounted for 5.7% of GDP,²³ and corporate

¹⁹ For more information, see CRS Report R41970, *Addressing the Long-Run Budget Deficit: A Comparison of Approaches*, by Jane G. Gravelle and CRS Report R41778, *Reducing the Budget Deficit: Policy Issues*, by Marc Labonte.

²⁰ In various reports, the Congressional Budget Office, the Government Accountability Office, and the Administration agree that the federal government's budget is on an unsustainable path. For more information, see the section of this report titled, "Long-Term Considerations."

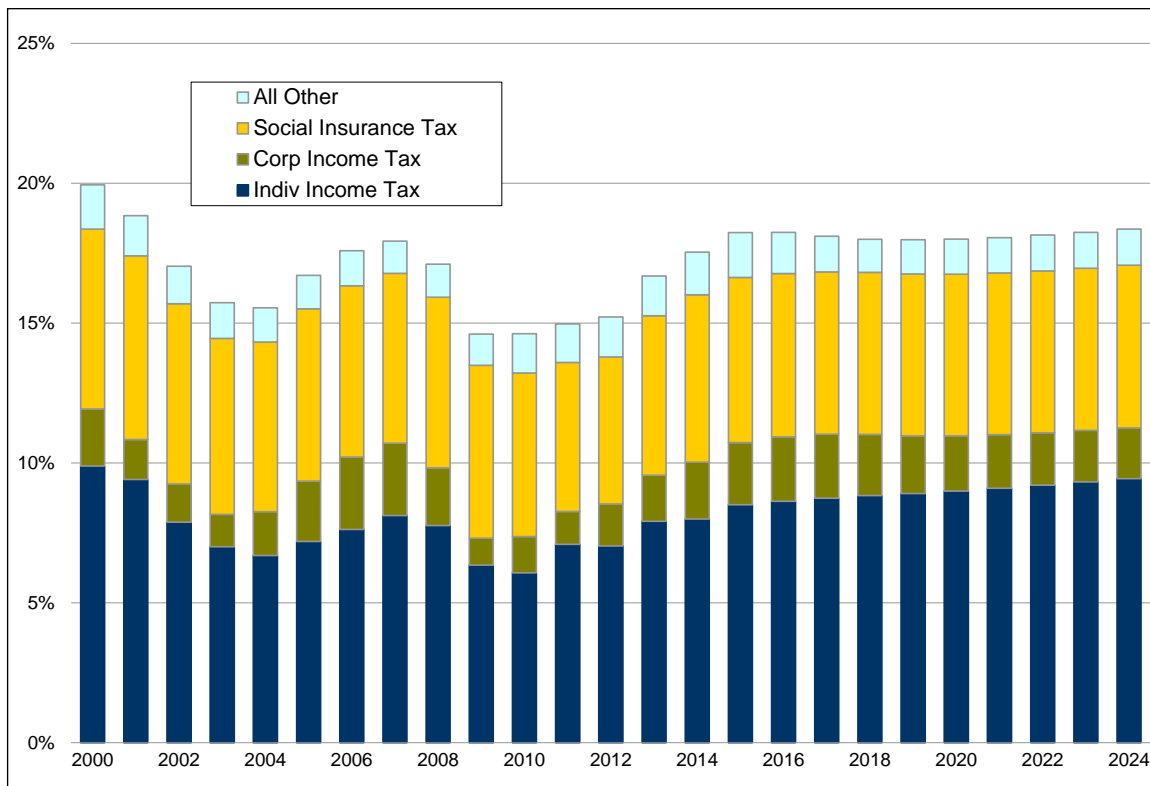
²¹ For more information on ATRA's tax provisions, see CRS Report R42894, *An Overview of the Tax Provisions in the American Taxpayer Relief Act of 2012*, by Margot L. Crandall-Hollick.

²² For more information, see CRS Report RL32808, *Overview of the Federal Tax System*, by Molly F. Sherlock and Donald J. Marples.

²³ Payroll tax revenue has declined over the last two fiscal years largely due to a reduction in the employee payroll tax rate from 6.2% to 4.2%, which began on January 1, 2011. This reduction expired on December 31, 2012.

income tax revenues equaled 1.6% of GDP in FY2013. **Figure 3** shows revenue collections between FY2000 and FY2024, as projected in the CBO baseline.

Figure 3. Revenue by Type, FY2000-FY2024
(as a percentage of GDP)



Source: CRS figure using data from CBO, *Historical Tables*, February 2014 and *The Budget and Economic Outlook: 2014 to 2024*, February 2014, Table I-2.

Notes: Data for FY2014 are estimates and data for FY2015-FY2024 are projections under the current law baseline.

Deficits, Debt, and Interest

The annual differences between revenue (i.e., taxes and fees) that the government collects and outlays (i.e., spending) result in the budget deficit (or surplus).²⁴ Annual budget deficits or surpluses determine, over time, the level of publicly held federal debt and affect the growth of interest payments to finance the debt.

Budget Deficits

Between FY2009 and FY2012, annual budget deficits as a percentage of GDP were sharply higher than deficits in any period since FY1945.²⁵ The unified budget deficit in FY2013 was \$680 billion, or 4.1% of GDP—the lowest level since FY2008. The unified deficit, according to some

²⁴ Most economists use data on federal outlays to track larger budget trends, while most program analysts use budget authority to track changes in specific program areas.

²⁵ The budget deficit peaked at 9.8% of GDP in FY2009.

budget experts, gives an incomplete view of the government's fiscal condition because it includes off-budget surpluses.²⁶ Excluding off-budget items (Social Security benefits paid net of Social Security payroll taxes collected and the U.S. Postal Service's net balance), the on-budget FY2013 federal deficit was \$720 billion.

Budget Deficit for FY2014

The February 2014 CBO baseline estimated the FY2014 budget deficit at \$514 billion or 3.0% of GDP. The decline in the estimated budget deficit for FY2014 is mainly the result of increased revenues due to higher individual and corporate tax collections. Outlays for FY2014 are estimated to be slightly lower, as a percentage of GDP, than FY2013. In October 2014, the Treasury Department and Office of Management and Budget reported a final deficit level for FY2014 of \$483 billion or 2.8% of GDP.²⁷

Federal Debt and Debt Limit

Gross federal debt is composed of debt held by the public and intragovernmental debt.²⁸ Intragovernmental debt is the amount owed by the federal government to other federal agencies, to be paid by the Department of the Treasury. This amount largely consists of money contained in trust funds, such as the Social Security trust fund, that has been invested in federal securities as required by law. Debt held by the public is the total amount the federal government has borrowed from the public and remains outstanding. This measure is generally considered to be the most relevant in macroeconomic terms because it is the debt sold in credit markets.

Changes in debt held by the public generally track the movements of the annual unified deficits and surpluses.²⁹ Whether or not the movements of gross federal debt will follow those of debt held by the public depends on how intragovernmental debt changes.

Historically, Congress has set a ceiling on federal debt through a legislatively established limit. The debt limit also imposes a form of fiscal accountability that compels Congress, in the form of a vote authorizing a debt limit increase, and the President, by signing the legislation, to take visible action to allow further federal borrowing when nearing the statutory limit. Since February 2013, however, three consecutive pieces of legislation have suspended the debt limit

²⁶ From an overall budget perspective, these surpluses are used to offset other federal spending, thereby decreasing the current budget deficit while increasing the amount of Treasury securities held in the Social Security Trust Funds. Off-budget surpluses have historically been large. However, declining surpluses in the Social Security Trust Funds will lead to off-budget deficits beginning in FY2018 according to the CBO baseline.

²⁷ "Joint Statement of Treasury Secretary Jacob J. Lew and Office of Management and Budget Director Shaun Donovan on Budget Results for Fiscal Year 2014," October 15, 2014, available at <http://www.treasury.gov/press-center/press-releases/Pages/jl2664.aspx>.

²⁸ Gross federal debt is also referred to as total debt or total public debt outstanding. Intragovernmental debt is also referred to as intragovernmental holdings or debt held by federal government accounts.

²⁹ An exception to this is with regard to the budgetary treatment of federal credit programs where the increase in the budget deficit can differ from the increase in the debt held by the public. This is a result of the accounting rules for federal credit programs under the Federal Credit Reform Act of 1990 whereby the budgetary cost of a new direct loan or loan guarantee is based on the subsidy cost over the life of the loan or loan guarantee rather than its net cash flow for that fiscal year. The impact of same direct loan or loan guarantee program on the debt held by the public is based on its net cash flow. This accounting difference was highlighted, for example, in FY2009 and FY2010 when the increase in the deficit was larger than that of debt held by the public due to the nature of the obligations incurred as a result of the government conservatorship of Fannie Mae and Freddie Mac and the TARP program. For more information, see CRS Report R42632, *Budgetary Treatment of Federal Credit (Direct Loans and Loan Guarantees): Concepts, History, and Issues for the 112th Congress*, by James M. Bickley.

accompanied by specific dates upon which the suspension expires. The debt limit is currently suspended as a result of the Temporary Debt Limit Extension Act (P.L. 113-83) through March 5, 2015.³⁰ It should be noted that the debt limit by itself has no effect on the borrowing needs of the government. The debt limit, however, can hinder the Treasury's ability to manage the federal government's finances when the amount of federal debt approaches this ceiling. In those instances, the Treasury has had to take unusual and extraordinary measures to meet federal obligations, leading to inconvenience and uncertainty in Treasury operations at times.³¹ At the end of FY2013 (September 30, 2013), federal debt subject to limit was approximately \$16,699 billion, of which \$11,976 billion was held by the public.³²

Net Interest

In FY2013, the United States spent \$221 billion or 1.3% of GDP on net interest payments on the debt. What the government pays in interest depends on market interest rates as well as on the size and composition of the federal debt. Currently, low interest rates have held net interest payments as a percentage of GDP below the historical average despite increases in borrowing to finance the debt.³³ Some economists, however, have expressed concern that federal interest costs could rise once the economy fully recovers, resulting in future strain on the budget. Interest rates are projected to gradually rise in the CBO baseline resulting in net interest payments of \$880 billion or 3.3% of GDP in FY2024. If interest costs rise to this level, they will be higher than the historical average.

Recent Budget Policy Legislation and Events³⁴

During the 112th and 113th Congresses, several legislative actions and events have affected the fiscal outlook. In August 2011, negotiations over increasing the debt limit resulted in the enactment of the Budget Control Act of 2011 (BCA). Subsequently, two pieces of legislation have revised this law. First, the American Taxpayer Relief Act of 2012 (ATRA) was enacted in January 2013 to deal with numerous expiring tax provisions, the BCA's across-the-board spending cuts (i.e., sequester), and other short-term considerations that were scheduled to take effect at the very end of 2012 or in early 2013. This combination of policies was referred to by some as the "fiscal cliff." During October 2013, certain activities of the federal government ceased operation (i.e., shutdown) due to a lapse in appropriations.³⁵ Several months after the shutdown, the second piece of legislation modifying the BCA, the Bipartisan Budget Act of 2013 (BBA), was enacted (December 2014). It contained new discretionary spending levels for FY2014 and FY2015 replacing the old levels as prescribed by the BCA. These actions are discussed in more detail below.

³⁰ For more information, see CRS Report R43389, *The Debt Limit Since 2011*, by D. Andrew Austin.

³¹ For more information, see CRS Report R41633, *Reaching the Debt Limit: Background and Potential Effects on Government Operations*, coordinated by Mindy R. Levit and U.S. Government Accountability Office, *Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203, February 2011.

³² U.S. Department of Treasury, *Daily Treasury Statement*, September 30, 2013, Table III-C.

³³ Since FY1970, the U.S. spent an average of 2.1% of GDP on interest payments.

³⁴ This section is not meant to address all changes in budget policy that have been enacted since 2011, but rather to highlight some of the major legislative actions and events.

³⁵ For more information, see CRS Report RL34680, *Shutdown of the Federal Government: Causes, Processes, and Effects*, coordinated by Clinton T. Brass.

Budget Control Act of 2011³⁶

The Budget Control Act of 2011 (BCA; P.L. 112-25) was enacted on August 2, 2011. The BCA contained a variety of measures intended to reduce the deficit by at least \$2.1 trillion over the FY2012-FY2021 period, along with a mechanism to increase the debt limit. The deficit reduction provisions included \$917 billion in savings from statutory caps on discretionary spending and the establishment of a Joint Select Committee on Deficit Reduction (Joint Committee) to identify further budgetary savings of at least \$1.2 trillion over 10 years. Because the Joint Committee was unable to reach an agreement, an automatic spending reduction process was triggered to begin in FY2013. This automatic process was intended to reduce spending levels further in the absence of other legislation to implement these changes.

American Taxpayer Relief Act of 2012³⁷

As the BCA's additional spending reductions were set to take effect in early 2013, the American Taxpayer Relief Act of 2012 (ATRA; P.L. 112-240) was signed into law by President Obama on January 2, 2013. ATRA included a number of spending provisions. First, ATRA postponed the start of the FY2013 BCA spending reductions until March 1, 2013. ATRA also reduced the FY2013 BCA spending reductions implemented via the automatic process by \$24 billion (i.e., two months' worth of reductions), to roughly \$85 billion equally divided between defense and non-defense. These provisions were offset by other changes in spending or revenue. Other spending changes unrelated to the BCA included an extension of certain unemployment benefits, prevention of reductions in Medicare physician payment rates, and a one-year extension of the 2008 farm bill.³⁸

In addition, ATRA made a variety of changes to tax policy, including the permanent extension of the 2001 and 2003 tax cuts on both ordinary income and capital gains and dividends for taxpayers with taxable income below \$400,000 (\$450,000 for married taxpayers filing jointly). For taxpayers with taxable income above these thresholds, the marginal tax rate on ordinary income rose from 35% to 39.6% on the portion of their income above these thresholds, and the top tax rate on long term capital gains and dividends rose from 15% to 20%. ATRA also reinstated the personal exemption phase-out (PEP) and limitation on itemized deductions (Pease) for taxpayers with adjusted gross income (AGI) above \$250,000 (\$300,000 for married couples filing jointly), allowing these limitations to expire for those with AGI below these thresholds. ATRA also extended the tax changes to a variety of tax credits, provided marriage tax penalty relief, and modified certain education-related tax incentives. ATRA also included a permanent "patch" for the alternative minimum tax and provided permanent estate and gift tax rules. Expiring provisions

³⁶ For more information, see CRS Report R43411, *The Budget Control Act of 2011: Legislative Changes to the Law and Their Budgetary Effects*, by Mindy R. Levit.

³⁷ For more information, see CRS Report R42884, *The "Fiscal Cliff" and the American Taxpayer Relief Act of 2012*, coordinated by Mindy R. Levit and CRS Report R42894, *An Overview of the Tax Provisions in the American Taxpayer Relief Act of 2012*, by Margot L. Crandall-Hollick.

³⁸ ATRA extended certain unemployment benefits and prevented reductions in Medicare physician payments rates through the end of calendar year 2013. It extended the 2008 farm bill through the end of FY2013. For more information on the current status of these programs, see CRS Report RL33362, *Unemployment Insurance: Programs and Benefits*, by Julie M. Whittaker and Katelin P. Isaacs, CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn, and CRS Report R43076, *The 2014 Farm Bill (P.L. 113-79): Summary and Side-by-Side*, coordinated by Ralph M. Chite.

commonly known as “tax extenders” were extended through the end of 2013. The 113th Congress may choose to address these “extenders” again in 2014.³⁹

Appropriations and Government Shutdown

On October 1, 2013, the federal government experienced a funding gap and partial shutdown after appropriations to fund many departments and agencies were not enacted by the beginning of FY2014.⁴⁰ The funding gap and associated shutdown ended on October 17, 2013, with the enactment of the Continuing Appropriations Act, 2014 (P.L. 113-46). The act provided interim appropriations through January 15, 2014. As part of the negotiations related to the passage of the Continuing Appropriations Act, the House and Senate agreed to go to conference on the FY2014 budget resolution. On December 9, 2013, Senator Patty Murray and Representative Paul Ryan released an agreement on discretionary spending caps for the remainder of the current fiscal year (FY2014) and the next fiscal year (FY2015), which was later enacted into law as the Bipartisan Budget Act of 2013.

The Bipartisan Budget Act of 2013

The Bipartisan Budget Act of 2013 (BBA; P.L. 113-67) replaced a portion of the BCA’s automatic spending process reductions for FY2014 (\$45 billion) and FY2015 (\$18 billion) with other deficit reduction provisions. These changes allow for more discretionary spending than was provided under the BCA for FY2014 and FY2015. Various deficit reduction measures were included to offset the cost of the increased discretionary spending.

Budget for FY2015

The Obama Administration released its FY2015 budget in two parts—the first on March 4, 2014, and the second on March 10, 2014. The President’s budget lays out for Congress the Administration’s views on national priorities and policy initiatives. Congress has also begun its consideration of the FY2015 budget.

Obama Administration’s FY2015 Budget

In his budget for FY2015, President Obama presented his policy agenda, largely focused on providing funding for various investments through the “Opportunity, Growth, and Security Initiative,” increasing infrastructure investment, and providing additional funding for early childhood education programs. These measures are paid for through a variety of proposals to increase taxes and reduce other spending over the next 10 years. The budget also proposes enactment of comprehensive immigration reform, tax reform, and other changes to federal health programs to achieve additional deficit reduction. Overall, the proposed budget would reduce the deficit from an estimated \$649 billion (3.7% of GDP) in FY2014 to \$434 billion (1.6% of GDP) in FY2024, averaging 2.2% of GDP over the next decade.

The President’s budget proposes a variety of tax and spending measures intended to pay for the initiatives discussed above, as well as other deficit reduction to replace some of the Budget

³⁹ For more information, see CRS Report R43124, *Tax Provisions Expiring in 2013 (“Tax Extenders”)*, by Molly F. Sherlock.

⁴⁰ For more information on lapses of appropriations, see CRS Report RL34680, *Shutdown of the Federal Government: Causes, Processes, and Effects*, coordinated by Clinton T. Brass and CRS Report RS20348, *Federal Funding Gaps: A Brief Overview*, by Jessica Tollestrup.

Control Act's automatic spending reduction process (often referred to as the Joint Committee sequester or Joint Committee enforcement). In August 2011, the Budget Control Act placed limits on spending via discretionary spending caps and included provisions for additional spending cuts to be implemented via an automatic process (for more information see the section titled "Recent Budget Policy Legislation and Events"). The budget proposes to eliminate the sequester on mandatory programs in FY2015. For the years beyond FY2015, the budget proposes to replace most of the automatic cuts (i.e., most of the reductions to the discretionary spending caps and all of the mandatory sequester) with spending cuts and tax increases. **Table 2**, below, compares the discretionary spending levels in current law to those in the President's budget proposal, before any adjustments.⁴¹

Table 2. Proposed Discretionary Spending Levels in President's FY2015 Budget Relative to Current Law, Before Adjustments

(\$ in billions)

	2015	2016	2017	2018	2019	2020	2021
Current Law:							
Defense	521	523	536	549	562	576	590
Non-Defense	492	493	504	516	530	543	556
President's FY2015 Budget:							
Defense	549	561	569	578	586	595	604
Non-Defense	516	525	532	540	549	557	565

Source: OMB, *Budget for Fiscal Year 2015, The Budget*, Table S-10 and CBO, *The Budget and Economic Outlook: 2014 to 2024*, February 2014, Box 1-1.

Notes: The levels listed above for the President's budget include FY2015 funding under the "Opportunity, Growth, and Security Initiative" and the proposal to reclassify certain programs from discretionary to mandatory spending.

In his budget, President Obama proposes an "Opportunity, Growth, and Security Initiative" to provide additional funding for unspecified discretionary programs in FY2015. This additional funding would be offset by changes to mandatory spending and revenue to be achieved over the FY2015-FY2024 period. The additional spending in FY2015 would be paid for over the next decade. The largest of these proposals include a reduction in agriculture subsidies and limiting the total accrual of tax-favored retirement accounts.⁴²

Savings are also generated from increasing the tax on tobacco products, eliminating various tax provisions to raise revenue, making changes to Medicare, Medicaid, and other federal health programs, and enacting tax and immigration reform proposals. The budget also proposes reductions in spending on Overseas Contingency Operations (OCO) through the implementation

⁴¹ The BCA allows the discretionary caps to be adjusted for specific types of spending, the largest of which are overseas contingency operations (OCO), disaster, and emergency funding.

⁴² Other than the FY2015 offsets for the "Opportunity, Growth, and Security Initiative," the budget does not indicate which of its savings proposals are specifically intended to pay for the changes to the BCA mentioned above.

of spending caps.⁴³ Together, these deficit reduction proposals total \$2,167 billion relative to the Administration's Adjusted Baseline between FY2015 and FY2024.⁴⁴

Finally, the President's Budget also includes a *Cuts, Consolidations, and Savings* section that contains proposed changes to 136 discretionary and mandatory programs, which would save approximately \$17 billion in FY2015 if enacted.⁴⁵

Deficit Projections in the FY2015 Budget

Consistent with the presentation of previous budgets, the Obama Administration provided three separate deficit projections.⁴⁶ First, OMB projected a Balanced Budget and Emergency Deficit Control Act (BBEDCA) baseline as required by statute. The BBEDCA baseline assumes that discretionary spending remains constant in real (i.e., inflation-adjusted) terms and revenue and mandatory (or direct) spending continue as under current law.⁴⁷ Under this scenario, the FY2015 deficit is projected to total \$568 billion.

The Obama Administration also projected an Adjusted Baseline, which in its view, provides a more transparent and realistic reflection of the federal government's current fiscal situation. This methodology is used to provide a basis for understanding how new policy choices would affect the fiscal outlook, essentially replacing the current BBEDCA baseline. The Administration's Adjusted Baseline assumes that discretionary spending will be limited by the discretionary caps put in place as part of the Budget Control Act and Medicare payments to physicians will not be reduced under the Sustainable Growth Rate (SGR) formula.⁴⁸ The deficit under this scenario is projected to reach \$561 billion in FY2015.

The final deficit projection, the Proposed Budget, illustrates the impact on the budget outlook if all of the policies proposed in the budget are implemented. In FY2015, the Administration projects that the deficit will reach \$564 billion. Both the Adjusted Baseline and the Proposed Budget project deficits throughout the 10-year budget window. Under the Proposed Budget, the deficit would fall from 3.1% of GDP in FY2015 to 1.6% of GDP by FY2024.⁴⁹ The deficit levels in the Proposed Budget scenario in the outyears are lower than both the BBEDCA baseline and the Adjusted Baseline figures.

What Do These Baselines Reflect?

As stated above, the Adjusted Baseline assumes that certain policies due to expire will be continued. The President's budget views the Adjusted Baseline as the most realistic projection of the budget deficit, and it is used as their benchmark to measure the impact of their budget

⁴³ OCO spending is currently exempt from the BCA discretionary spending caps. Whether or not savings reducing OCO spending from current levels should be considered savings has been controversial. For CBO's take on the issue, see Congressional Budget Office, Director's Blog, *Can Proposed Reductions in Future War-Related Spending Be Used To Offset Proposed Deficit Increases in Other Areas?*, February 1, 2012 and CBO, *Capping War-Related Spending*, February 10, 2014.

⁴⁴ Office of Management and Budget, *Budget for Fiscal Year 2015, The Budget*, Table S-2.

⁴⁵ Office of Management and Budget, *Budget for Fiscal Year 2015, The Budget*, p. 153.

⁴⁶ For details of these projections, see U.S. Office of Management and Budget, *Budget for Fiscal Year 2015, The Budget*, Tables S-1 (Proposed Budget) and S-8 (BEA Baseline and Adjusted Baseline).

⁴⁷ For a description of the policies included in the various baselines, see U.S. Office of Management and Budget, *Budget for Fiscal Year 2015, Analytical Perspectives*, pp. 381-385.

⁴⁸ Currently physician payment rates are scheduled to be reduced on April 1, 2014. The adjusted baseline assumes that there will be a 0% update for physician payment rates after that date.

⁴⁹ U.S. Office of Management and Budget, *Budget for Fiscal Year 2015, The Budget*, Table S-2.

proposals. The Proposed Budget, however, is the one that illustrates the resulting budget outlook if all of the policies proposed by the President were implemented. Whether or not a certain policy proposal increases or decreases the deficit depends on which baseline is used as the starting point. Ultimately, the question of whether or not the amount of deficit reduction is sufficient can only be measured by actual budget outcomes (i.e., whether the budget deficit is higher or lower in the future relative to today) and whether or not the budget is on a sustainable path.

There are no real limits on what assumptions can be used to construct the Adjusted Baseline as opposed to the BBEDCA baseline, whose parameters were set by legislation. The Adjusted Baseline in the FY2015 budget assumes, for example, increases in spending as a result of eliminating the reduction in Medicare physician payments under the SGR formula. Because this policy serves to increase the deficit, this policy has no cost in the Administration's Proposed Budget when it is measured against the constructed Adjusted Baseline. If it were measured under the BBEDCA baseline, the SGR fix would increase the deficit. In other words, because the Administration assumes that Medicare physician payments would be maintained at current year levels in its Adjusted Baseline, at a cost of \$110 billion between FY2015 and FY2024, this proposal does not increase the deficit in the Proposed Budget.⁵⁰

A similar methodology can be used in understanding how the funding for Overseas Contingency Operations is being accounted for in each baseline. Both the Adjusted Baseline and BBEDCA baseline assume that OCO funding will continue at current year levels, adjusted for inflation. In the Proposed Budget, the Administration assumes a reduction in OCO funding. As a result, the Proposed Budget allocates a reduction in the deficit of \$695 billion over the FY2015-FY2024 period for reduced OCO costs relative to the Adjusted Baseline and the BBEDCA baseline.

The FY2015 Budget Resolution

The budget committees in the House and Senate each work to develop a budget resolution as they receive information and testimony from various sources, such as the Administration, CBO, and congressional committees with jurisdiction over spending and revenues. For FY2015, the Bipartisan Budget Act (BBA) contained a provision directing the House and Senate Budget Committee Chairmen to file spending and revenue levels in the *Congressional Record* that would be enforceable in the same manner as a concurrent budget resolution. However, nothing would preclude Congress from acting on a budget resolution for FY2015 even after levels have been filed.

As specified by the BBA, levels would be filed in this manner if the House and Senate do not agree to a budget resolution for FY2015 by April 15, 2014.⁵¹ The levels would include spending levels for the House and Senate Appropriations Committees (302(a) allocations) consistent with the discretionary spending caps (\$521 billion for defense and \$492 billion for non-defense) and mandatory spending and revenue levels "consistent with the most recent baseline of the Congressional Budget Office." Such action would be similar to prior years when the House and Senate could not reach agreement on the budget resolution and both took action to "deem" enforceable budgetary levels. In the past, deeming resolutions have also been used when the

⁵⁰ This figure does not include related debt service costs. U.S. Office of Management and Budget, *Budget for Fiscal Year 2015, The Budget*, Table S-8.

⁵¹ The timetable established in the Congressional Budget Act directs the Senate Budget Committee to report a budget resolution by April 1, and for the House and Senate to reach final agreement on a budget resolution by April 15. For more information on the congressional budget process, see CRS Report RS20368, *Overview of the Congressional Budget Process*, by Bill Heniff Jr.

House and Senate are late in reaching final agreement on a budget resolution.⁵² It has been reported that Senate Budget Committee Chairwoman Patty Murray has signaled that the provisions contained in the BBA make a budget resolution for FY2015 unnecessary.⁵³

House Budget Resolution

On April 2, 2014, the House Budget Committee reported a budget resolution (H.Con.Res. 96, 113th Congress) by a vote of 22-16. On April 10, 2014, the resolution was agreed to by the House by a vote of 219 to 205. The resolution provided for revenue levels of \$3,305 billion and outlays of \$3,664 billion in FY2015 for a deficit of \$380 billion, or approximately 2.1% of GDP. By FY2024, the budget is projected to reach a surplus of \$5 billion. This includes a “macroeconomic fiscal impact” of \$74 billion in FY2024, without which there would be no budget surplus in that year. Debt held by the public is projected to rise in nominal terms from \$13,213 billion in FY2015 to \$15,176 billion by FY2024.⁵⁴

The budget proposal contains several policy changes affecting spending. Under the House budget resolution, overall discretionary spending would be reduced from its current law levels. Through FY2021, the BCA’s caps constrain discretionary spending. The House budget resolution would reduce the non-defense discretionary spending caps under current law and would reduce non-defense discretionary spending relative to the CBO baseline between FY2022 and FY2024. The defense discretionary spending caps would be increased in each fiscal year through FY2021 and defense discretionary spending would be increased between FY2022 and FY2024 relative to the CBO baseline. The reductions to non-defense discretionary spending (\$791 billion over the FY2015 to FY2024 period) would more than offset the increases in defense discretionary spending (\$483 billion over the FY2015 to FY2024 period).

In addition to these changes to spending, the budget resolution also proposes other changes to mandatory programs, specifically to Medicare and Medicaid, and proposes to replace the Patient Protection and Affordable Care Act (ACA). Overall, the budget resolution proposes to reduce spending by \$5.9 trillion between FY2015 and FY2024 relative to the current CBO baseline. Spending levels would average roughly 19.0% of GDP between FY2015 and FY2024 under the policies of the resolution.

On the revenue side, the House Budget Committee recommends no changes to the overall revenue levels under current law. However, in the report accompanying the budget resolution, the committee recommends implementation of comprehensive tax reform with the ultimate goal of replacing the current system with two tax brackets of 10% and 25% and repealing the Alternative Minimum Tax. The corporate tax rate would also be reduced from 35% to 25%. Revenue collection would average roughly 18.1% of GDP between FY2015 and FY2024 under the policies of the resolution.

Considerations for Congress

Ongoing budgetary challenges remain, which may result in Congressional action. In the short term, issues related to deficit reduction and the slow economic recovery may continue to dominate the policy debate. Over the long term, increased spending on entitlement programs, as

⁵² For more information, see CRS Report RL31443, *The “Deeming Resolution”: A Budget Enforcement Tool*, by Megan S. Lynch.

⁵³ Burgess Everett, “Patty Murray won’t seek budget resolution,” *Politico*, February 28, 2014.

⁵⁴ House Budget Committee, *The Path to Prosperity: Fiscal Year 2015 Budget Resolution*, April 2014, Table S-1.

currently structured, will likely contribute to rising deficits and debt, placing ever-increasing focus on how to achieve fiscal sustainability.

Addressing Ongoing Budget Issues

Various budget issues may feature prominently in the Congressional debate in the near-term. Ongoing discussions over the budget resolution, FY2015 appropriations levels, and the Budget Control Act and related legislation may highlight the agenda. As discussed above, the Bipartisan Budget Act of 2013 (BBA) put into place new discretionary spending caps for FY2014 and FY2015. As the FY2015 budget and appropriations process continues, the BBA levels were intended to serve as an agreement on the amount of discretionary spending to be provided for these fiscal years. Beyond that however, discretionary spending levels for FY2016 to FY2021 remain as prescribed in the BCA. Therefore, it is possible that Congress and the President may work to change discretionary spending levels in future years.

FY2015 Appropriations

On September 19, 2014, the President signed a continuing resolution into law (P.L. 113-164) providing appropriations for FY2015 through December 11, 2014.⁵⁵ Further appropriations will need to be enacted on or before that date to avoid a funding lapse.

Debt Limit

Though discussions may continue over spending levels, the debate over the debt limit is not expected to resume until spring 2015. This is a result of legislation to suspend the debt limit, which was enacted on February 15, 2014, and suspends the debt limit through March 15, 2015 (P.L. 113-83). This is the third consecutive measure suspending the debt limit.

Economic Considerations

The economy is still recovering from the most recent recession, which lasted from December 2007 to June 2009. Growth remains moderate, primarily due to slack in the labor and capital markets. Most economists expect unemployment rates to remain elevated for the medium term. During the recession and for several subsequent years, the budget deficit grew largely as a result of government actions taken to combat the economic downturn as well as significantly lower revenue and higher spending levels directly attributable to the economic conditions. CBO's projections, however, assume steady economic growth over the next 10 years, taking into account that changes in economic conditions will average out over the period. A recession over the budget window is likely and, if it should actually occur, would temporarily worsen the deficit relative to the baseline. In other years, an expansion could result in a lower deficit relative to the baseline. Other unforeseen events could also change the fiscal outlook.

As the economy continues to recover, revenue should remain on an upward trajectory as unemployment continues to fall and income tax collections continue to rise. Spending should stabilize due to decreased reliance on federal programs meant to provide assistance during economic downturns. This should lead to a period of more sustainable budget deficits. The resulting large budget deficits and high debt levels will have an effect for many years, though many argued that fiscal stimulus and other actions were needed to help the economy recover.

⁵⁵ For more information, see CRS Report IN10148, *H.J.Res. 124, the FY2015 Continuing Resolution*, by Jessica Tollestrup.

Many budget analysts are concerned about future levels of federal debt and acknowledge that the current spending and revenue collection cannot continue at current or projected future levels. However, significant deficit reduction at this time may be harmful to the ongoing economic recovery. On the other hand, the longer that the country continues without a plan to stabilize its fiscal future, the more costly reform (i.e., more severe reductions in spending or larger increases in taxes) may ultimately be. In addition, the likelihood of a severe fiscal crisis caused by an unwillingness of private investors to continue financing unsustainable deficits may increase, and, if that occurs, reforms may be forced by events rather than being deliberate and planned.⁵⁶

Long-Term Considerations

Occasional deficits, in and of themselves, are not necessarily problematic. Deficit spending can allow governments to smooth outlays and taxes to shield taxpayers and program beneficiaries from abrupt economic shocks in the short term, while also temporarily boosting GDP when the economy is underperforming. Persistent deficits, however, lead to growing levels of federal debt that may lead to higher interest payments and may also have adverse macroeconomic consequences in the long term, including slowing investment and lowering economic growth. Since the debt cannot grow faster than GDP indefinitely, large deficits will eventually need to be reduced through increases in taxes, reductions in spending, or both.

The federal government faces long-term budget challenges. Some measures of fiscal solvency in the long term indicate that, under current policy, the United States faces major future imbalance, specifically as it relates to rising health care costs and the likely impact on government-financed health care spending. Even as Congress and the President worked to enact deficit reduction legislation (i.e., the BCA), legislators are seen not to have made significant changes to the part of the budget that is projected to grow. Therefore, many budget analysts believe that additional savings are required to put the budget on a sustainable path over the long term. Further, over the last two years, many of those deficit reduction provisions have been softened. Under the current law baseline, deficits continue to be projected over the budget window.

CBO, GAO, and the Administration agree that the current mix of federal fiscal policies is unsustainable in the long term. The nation's aging population, combined with rising health care costs per beneficiary, may keep federal health costs rising faster than per capita GDP. CBO projected in September 2013 that under current policy, federal spending on federal health programs (including Medicare, Medicaid, CHIP, and exchange subsidies) would grow from 4.7% of GDP today to 7.6% of GDP in 2035, and 13.5% by 2085.⁵⁷ The 2013 Economic Report of the President also projected that future federal spending on Medicare and Medicaid would rise significantly under current law projections.⁵⁸ Though these forecasts are highly uncertain, it seems probable that spending on these programs will rise as a share of GDP over time.

In addition, growing debt and rising interest rates are projected to consume a greater share of future federal spending. Under current law, CBO projects that spending to finance the federal debt will grow rapidly from 1.3% of GDP today, to 4.5% of GDP in FY2035, and 11.4% of GDP in

⁵⁶ Congressional Budget Office, *The Budget and Economic Outlook: 2014 to 2024*, February 2014, pp. 17-18.

⁵⁷ Congressional Budget Office, *The Long-Term Budget Outlook*, September 2013, "Supplemental Material."

⁵⁸ If healthcare costs continue to grow at the same rate as GDP, as they have over the past several years, healthcare spending 75 years from now will be roughly equal to what it is today as a percentage of GDP. Historically, however, growth rates in healthcare costs per capita have outpaced the growth in the economy by a significant margin. Council of Economic Advisors, *Economic Report of the President*, March 2013, Figure 5-8 and p. 30.

FY2085.⁵⁹ GAO's recent long-term fiscal simulations, under an alternative policy scenario, projected that debt held by the public as a share of GDP would exceed the post-World War II historical high in about 15 years.⁶⁰

Keeping future federal outlays at 20% of GDP, or approximately at its historical average, and leaving fiscal policies unchanged, according to CBO projections, would require drastic reductions in all spending other than that for Medicare, Social Security, and Medicaid, or reining in the costs of these programs. As shown in **Table 3** below, under CBO's extended baseline, maintaining the debt to GDP ratio at today's level (73%) through FY2038 would require an immediate and permanent cut in non-interest spending or revenues or some combination of the two in the amount of 0.9% of GDP (or about \$150 billion in FY2014 alone) in each year. Maintaining this debt-to-GDP ratio beyond FY2038 would require additional savings. If policy makers wanted to lower future debt levels relative to today, the annual spending reductions or revenue increases would have to be larger. For example, in order to bring debt as a percentage of GDP in FY2038 down to the same level it was in FY2008 (39% of GDP), spending reductions or revenue increases or some combination of the two would need to total roughly 2.1% of GDP (or \$360 billion in FY2014 alone) in each year.⁶¹

Table 3. Fiscal Gap Under CBO's Extended Baseline

(Percentage of gross domestic product)

	2038	2063	2088
Changes in Spending and/or Revenue per Year required to maintain today's debt-to-GDP ratio (73%) in:	0.9%	1.4%	1.7%
Changes in Spending and/or Revenue per Year required to lower the debt-to-GDP ratio to 2008 levels (39%) in:	2.1%		

Source: CBO, *The 2013 Long-Term Budget Outlook*, September 2013, Table B-1 and pp. 10-11.

As the economic recovery continues, Congress may focus more effort on reducing the deficit and reining in the debt. This would require less spending, more revenue, faster-than-average economic growth, or a combination of these things. Debt requires interest payments that can strain budgets if debt levels and interest rates are high. High debt levels could limit the government's flexibility in meeting its obligations or in responding to emerging needs of its citizens. Ultimately, failing to take action to reduce the projected growth in the debt might lead to future insolvency.⁶²

⁵⁹ Congressional Budget Office, *The Long-Term Budget Outlook*, September 2013, "Supplemental Material."

⁶⁰ Government Accountability Office, *The Federal Government's Long-Term Fiscal Outlook: Spring 2013 Update* (GAO-13-481SP), April 11, 2013, p. 1.

⁶¹ U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, September 2013, pp. 10-11 and Table B-1.

⁶² See Alan Auerbach and William Gale, "The Economic Crisis and the Fiscal Crisis: 2009 and Beyond: An Update," Tax Policy Center working paper, September 2009, available at http://www.brookings.edu/~media/Files/rc/papers/2009/06_fiscal_crisis_gale/06_fiscal_crisis_gale_update.pdf.

Appendix. Budget Documents

CBO Documents

The Congressional Budget Office (CBO) provides data and analysis to Congress throughout the budget and appropriations process. Each January, CBO issues a *Budget and Economic Outlook* that contains current-law baseline estimates of outlays and revenues. In March, CBO typically issues an analysis of the President's budget submission with revised baseline estimates and projections. These documents can be delayed as a result of the legislative agenda or if the President's Budget is off schedule. In late summer, CBO issues an updated *Budget and Economic Outlook* with new baseline projections.

In these documents, CBO sets a current-law baseline as a benchmark to evaluate whether legislative proposals would increase or decrease outlays and revenue collection. Baseline estimates are not intended to predict likely future outcomes, but to show what spending and revenues would be if current law remained in effect. CBO typically evaluates the budgetary consequences of legislative proposals and the Joint Committee on Taxation (JCT) evaluates the consequences of revenue proposals.

CBO also releases other periodic publications focusing on the future fiscal health of the United States. In their publication, *The Long-Term Budget Outlook*, CBO makes projections on the state of the federal budget over the next 75 years. They discuss spending and revenue levels and the related issues that they expect will arise under different policy assumptions. In their *Budget Options* volumes, they provide specific policy options and the impact they will have on spending and revenues over a 10-year budget window. They also provide arguments for and against enacting each policy.

OMB Documents

The President's Budget contains five major volumes: (1) *The Budget*; (2) *Historical Tables*; (3) *Analytical Perspectives*; (4) *Appendix*; and (5) *Supplemental Materials*.⁶³ These documents lay out the Administration's projections of the fiscal outlook for the country, along with spending levels proposed for each of the federal government's departments and programs. The *Historical Tables* volume also provides significant amounts of budget data, much of which extends back to 1962 or earlier. Along with the Administration's budget documents, the Department of the Treasury also releases its *Green Book*, which provides further detail on the revenue proposals that are contained in the budget.⁶⁴

⁶³ The President's budget proposals can be found on the OMB website at <http://www.whitehouse.gov/omb/>. The Supplemental Materials include the Federal Credit Supplement, the Object Class Analysis, the Balances of Budget Authority, and the Public Budget Database.

⁶⁴ The Green Book is available at http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx.

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